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# PrimeStone

Long Term Value Creation Through Constructive Active Sponsorship



Ira Sohn Conference – London, November 2018

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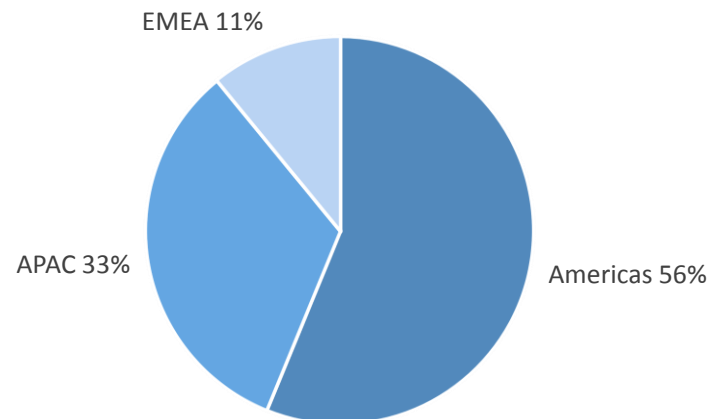
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# Spirent Communications (SPT LN)

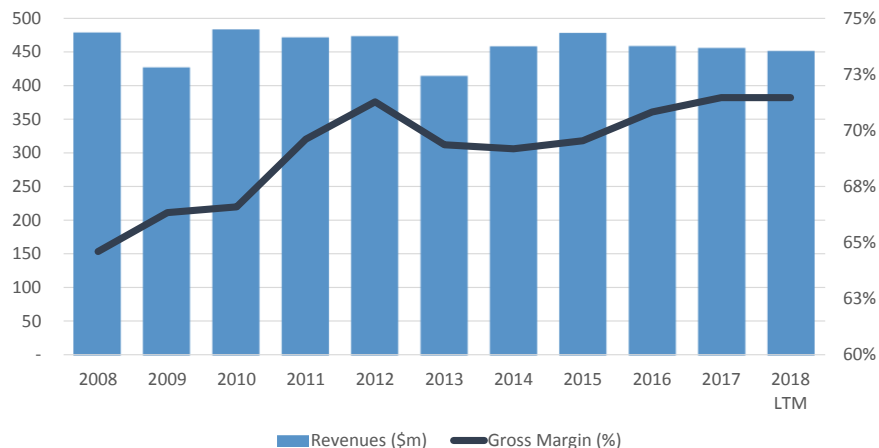
## Business Description

- Leading global supplier of test solutions for communication equipment across a wide range of technologies
  - Providing complex hardware and software tools to test the performance of network equipment, devices and applications
- Operating in three divisions
  - Networks & Security (59% of adj. operating profit LTM<sup>1</sup>)
  - Lifecycle Service Assurance (29%)
  - Connected Devices (12%)
- Listed and headquartered in the UK with majority of revenues generated in the US and Asia

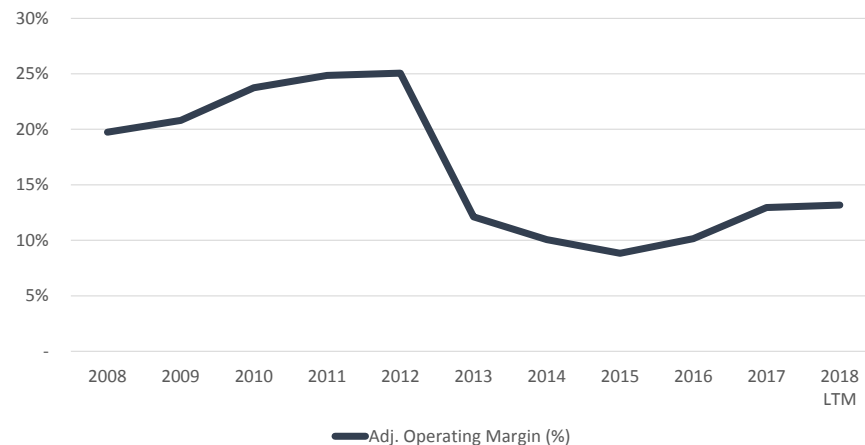
## Revenues LTM



## Revenues & Gross Margin



## Adj. Operating Profit Margin



# Investment Merits

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1

**Attractive Business**

2

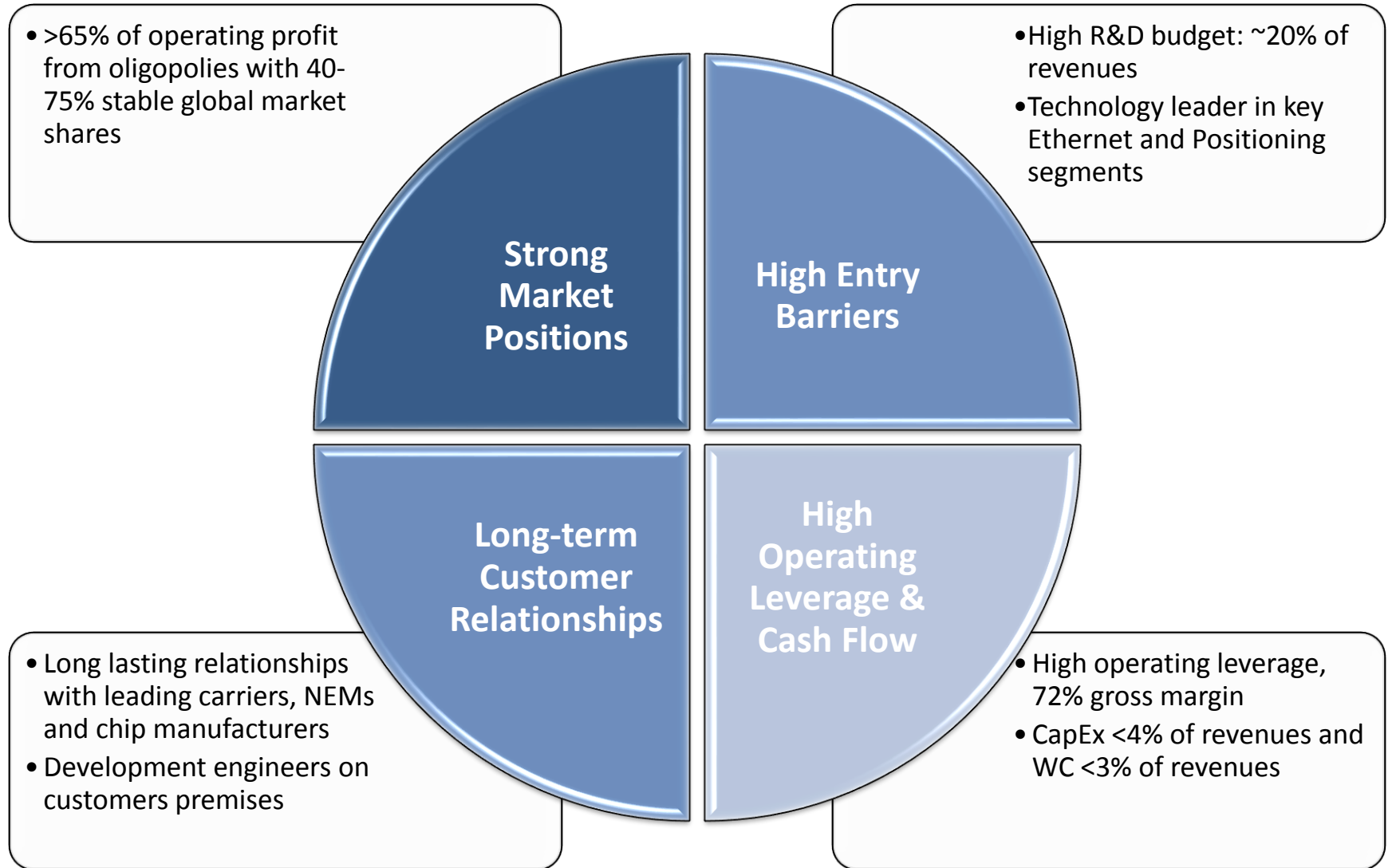
**Numerous Value Creation Levers**

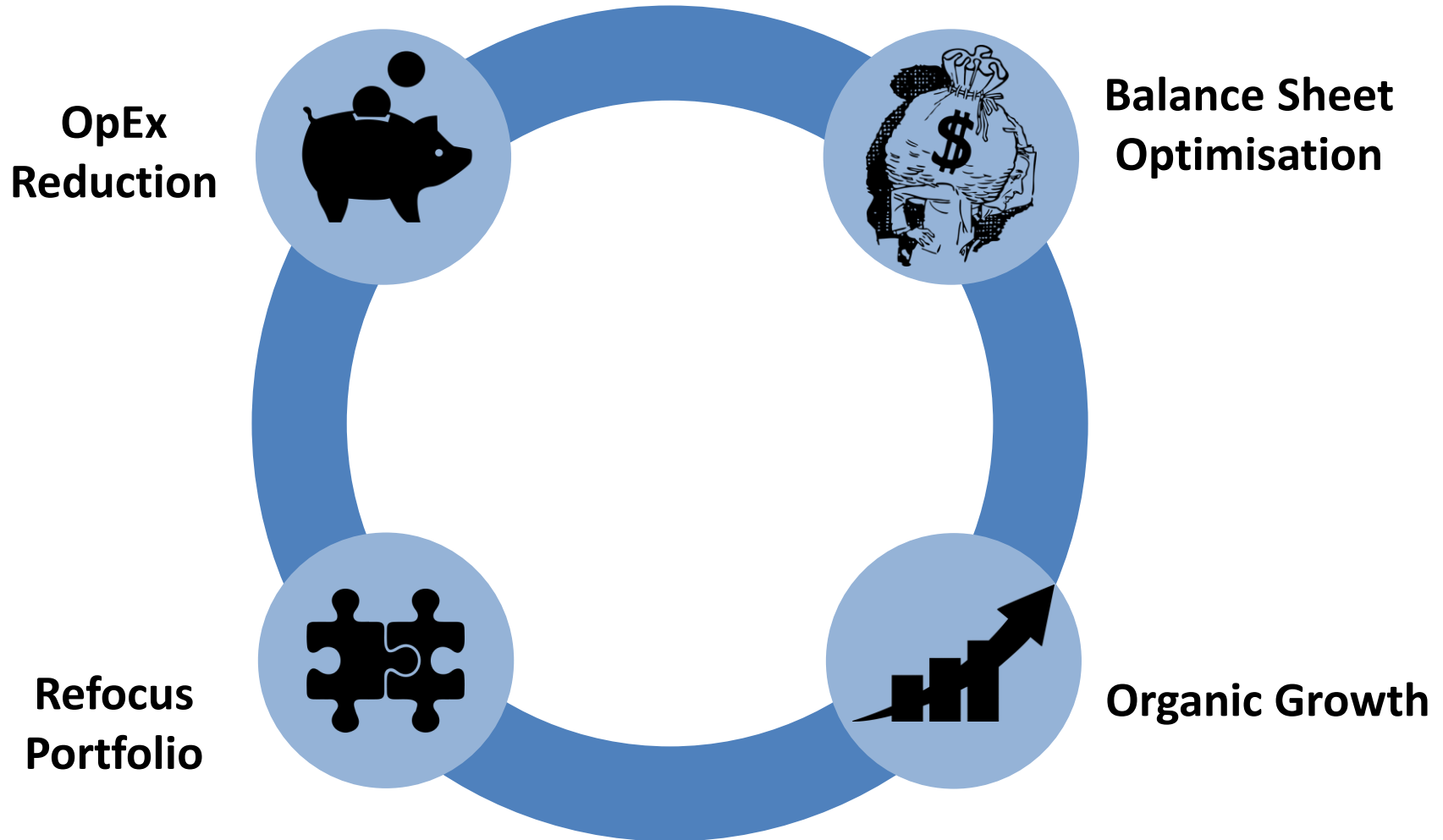
3

**Improvement Underway**

4

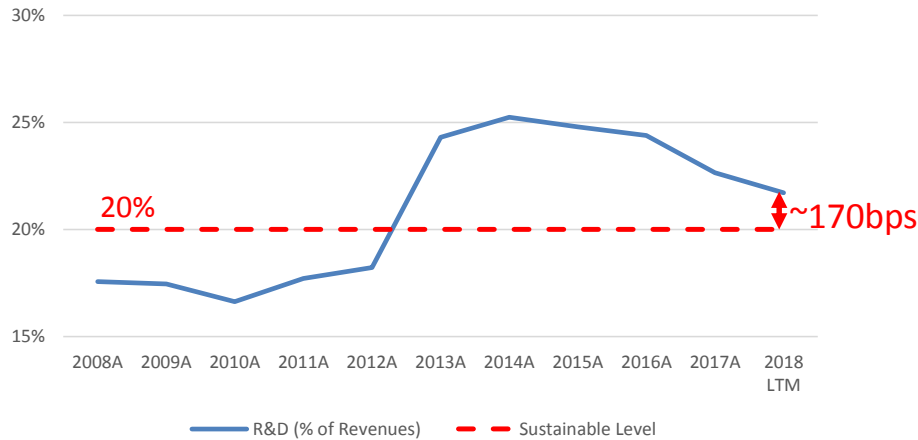
**Significant Upside Potential**



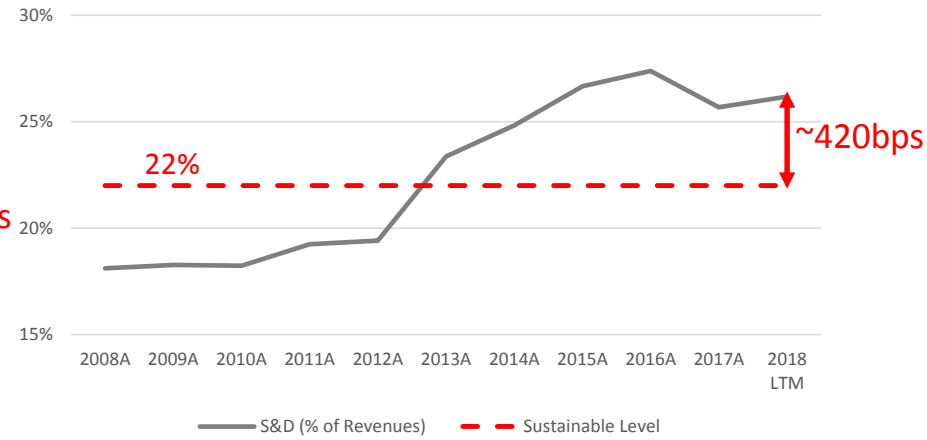




## Spirent R&D Expenses



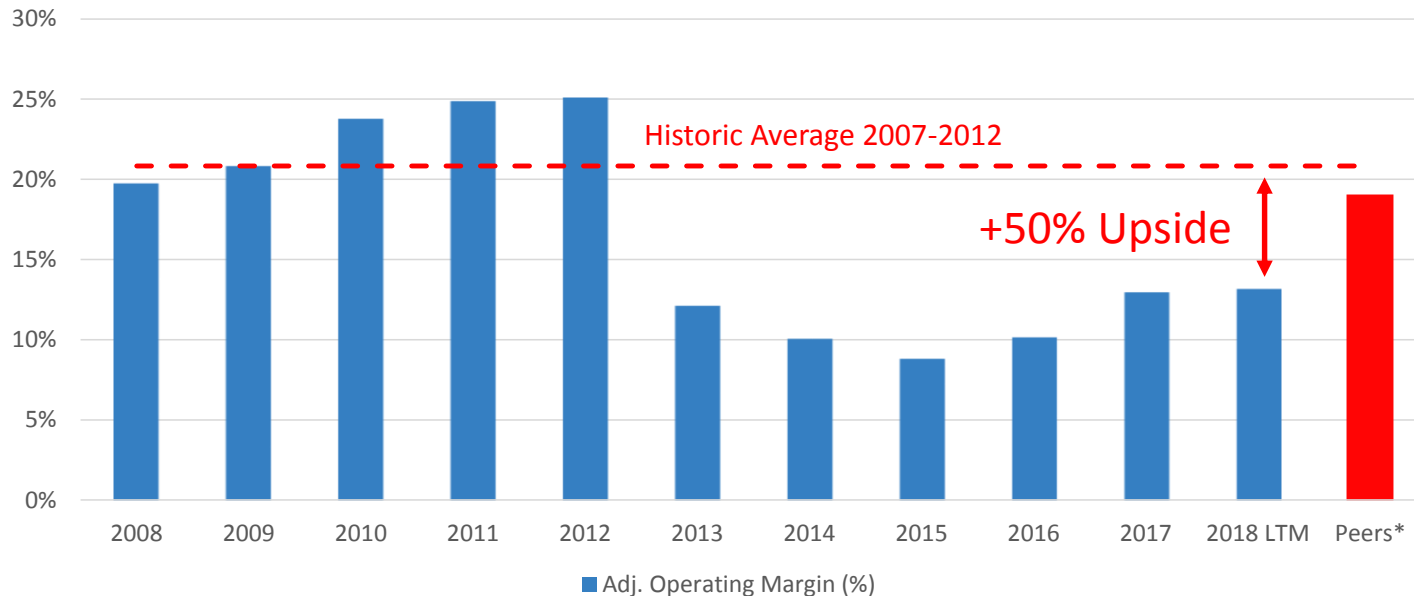
## Spirent S&D Expenses



- \$180 million additional cumulative spending in OpEx 2013-2017 over 20% / 22% of sales benchmark for Research & Development (“R&D”) and Sales & Distribution (“S&D”) respectively
- Leading edge and highly competitive product portfolio
- OpEx reduction started in 2016 but still plenty of room for improvements left



## Adj. Operating Margin

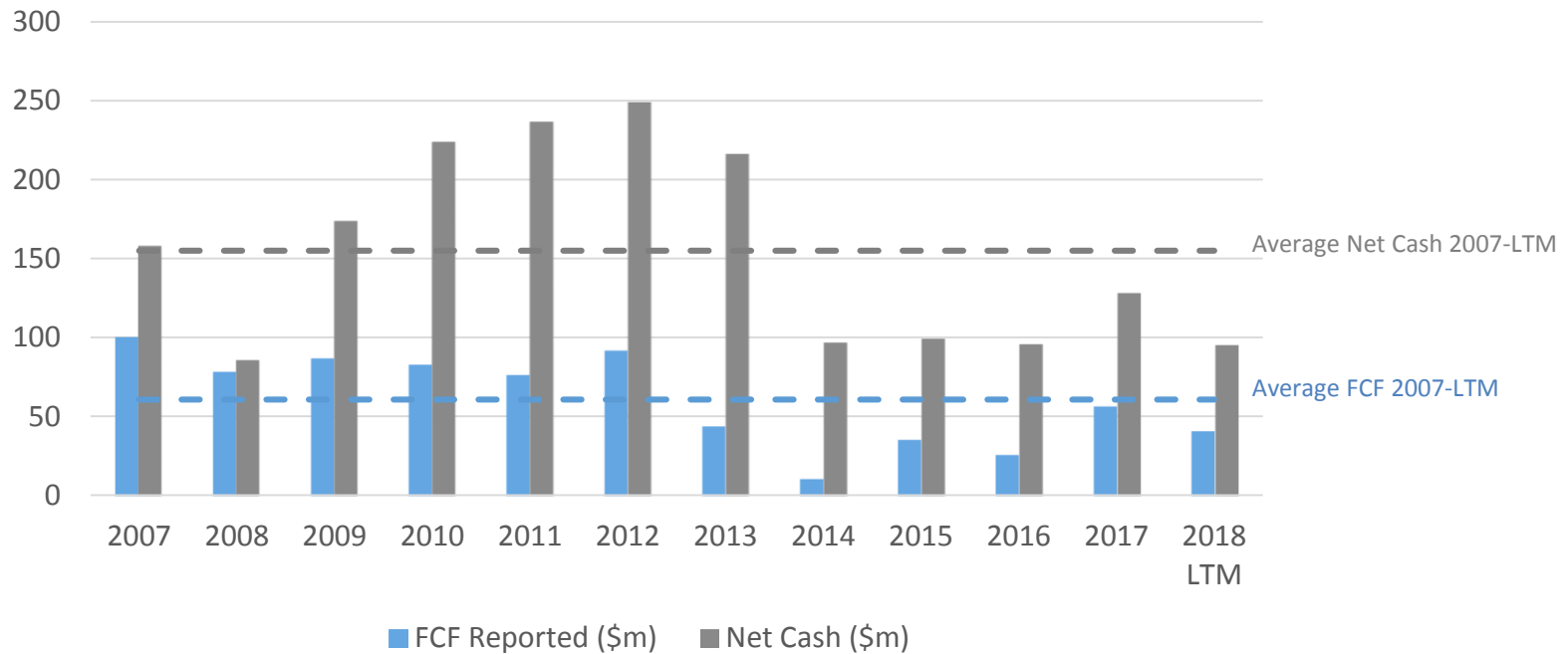


- Company currently running on a rebounding but still depressed 13% adj. operating profit margin due to overspending
- Substantial margin upside left in the business, up to 50% as suggested by historical performance and benchmarks





## Net Cash & Free Cash Flow

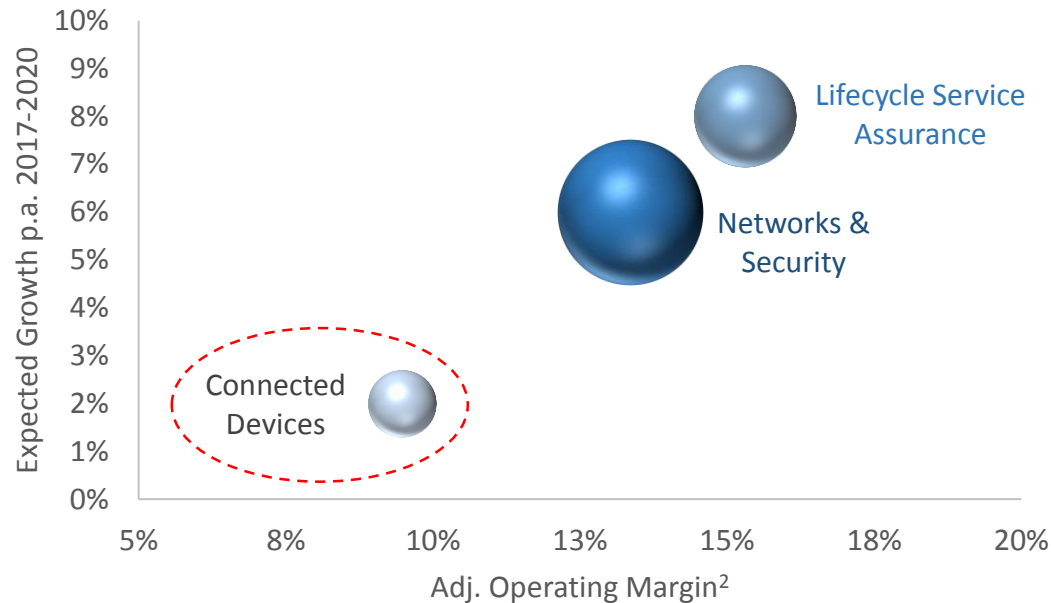


- Current net cash position of c. \$100 million
- Free Cash Flow (“FCF”) always positive since 2007

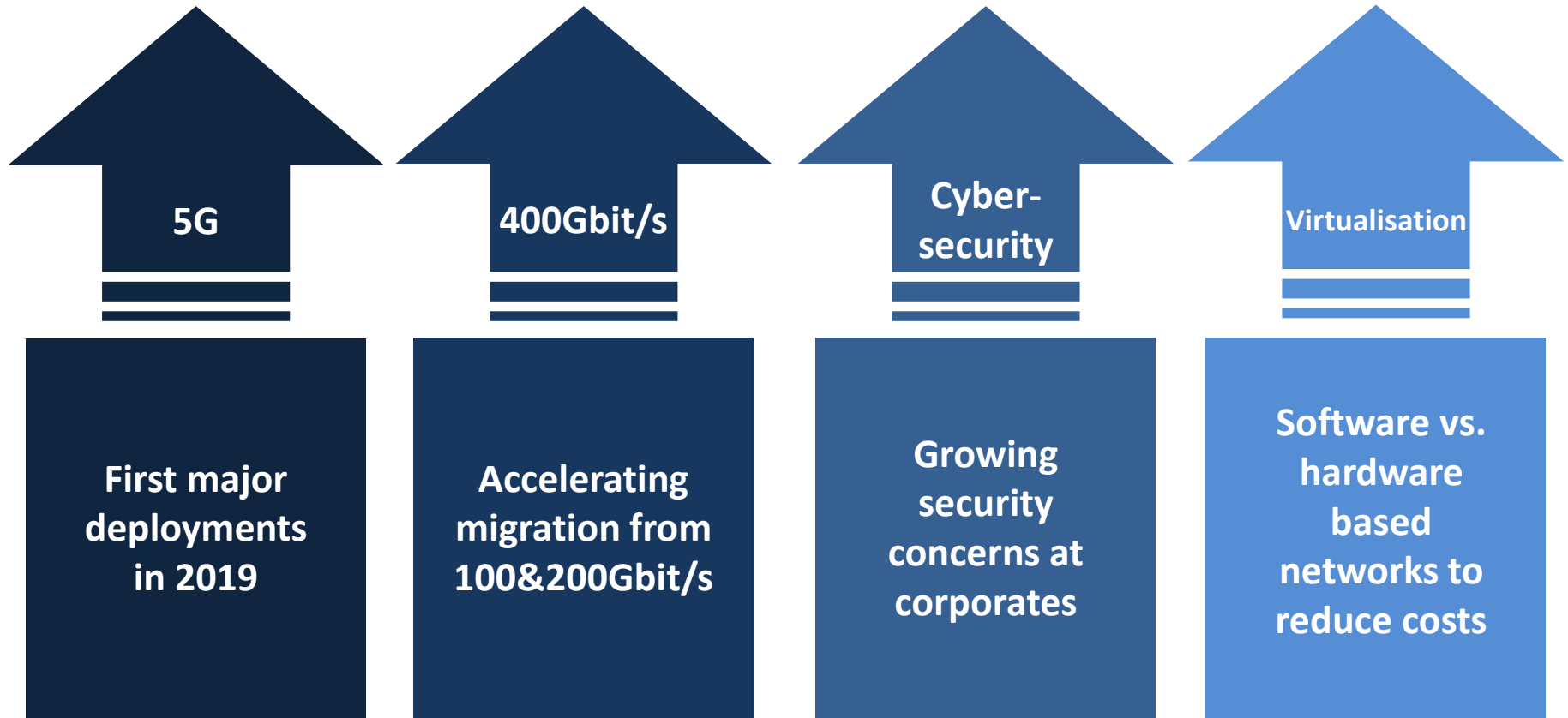
**Room for up to \$100 million share buyback/special dividend (11% of Mcap.)  
while maintaining a debt free balance sheet**



## Spirent Business Portfolio<sup>1</sup>



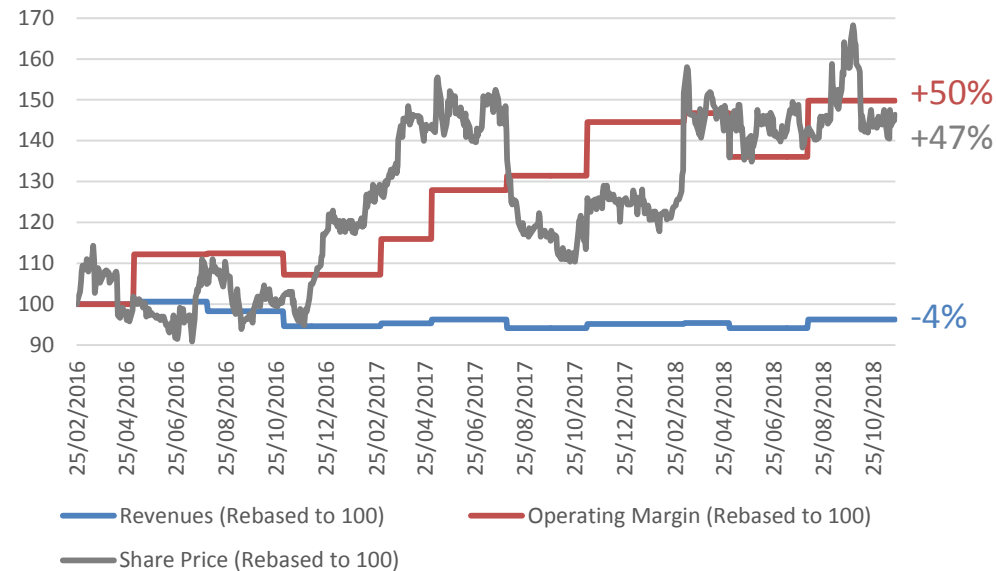
- Connected Devices: Historically a key profit contributor, now a distant #3-4 player in low growth market with substantial R&D investment requirements
- Management attention and resources better allocated to core segments with stronger market shares, attractive growth prospects and substantially higher margins



**3-5% p.a. organic growth potential with >70% drop through**

- New higher quality Board of Directors more focused on shareholder value
  - 7 Directors out of 8 changed since 2016, incl. Chairman and CFO
- Management focused on executing value creation plan
  - Costs: Adj. operating profit margin improved almost 50% since the trough in 2015
  - Portfolio: Small divestments in Connected Devices initiated in 2017
  - Balance Sheet: Special dividend of \$30 million in 2018
  - Growth: Promising prospects for 400G Ethernet and 5G test equipment

Share Price Lifted By Profitability Improvement



## 4 Valuation Undemanding In Light Of Upside Potential

### Valuation As Of 21 November 2018

| (x)                      | EV/Sales   |            | EV/EBITA   |            | P/E       |           |
|--------------------------|------------|------------|------------|------------|-----------|-----------|
|                          | 2018       | 2019       | 2018       | 2019       | 2018      | 2019      |
| SPT Consensus            | 1.8x       | 1.7x       | 12.9x      | 10.9x      | 17.9x     | 15.5x     |
| Peers <sup>1</sup>       | 2.4x       | 2.3x       | 14.8x      | 12.8x      | 18.3x     | 15.4x     |
| <b>Discount to Peers</b> | <b>33%</b> | <b>35%</b> | <b>15%</b> | <b>17%</b> | <b>2%</b> | <b>0%</b> |

**10-30% discount to peers, depressed margin a key reason**

# Conclusion: Significant Value Creation Potential Over The Next 3 Years

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## Multiple Value Creation Levers

|  | Share Price Impact 2021 |
|--|-------------------------|
| Free Cash Flow/Share buy-back <sup>1</sup> | 15-20%                  |
| Revenue Growth <sup>2</sup>                | 10-15%                  |
| Operating Margin Improvement <sup>3</sup>  | 50%                     |
| Re-rating to peer level                    | 10-30%                  |
| <b>Total FYE 2021</b>                      | <b>+85-115%</b>         |
| Take-over Premium                          | >20%                    |

Source: PrimeStone Analysis, Company Reports, Bloomberg

Notes:

1 FCF based on 2018 consensus revenues / adj. EBITA, assuming no growth or margin improvement 2019-2021, exit multiple of 12.9x adj. EBITA 2021 assuming no dividend pay-out 2018-2021

2 +3-5% organic growth p.a. 2019-2021, 71.5% gross margin, adj. EBITA margin flat at consensus 2018 level (13.8%), exit multiple of 12.9x adj. EBITA 2021 assuming no dividend pay-out 2018-2021

3 Gradual improvement of adj. EBITA margin from 13.8% 2018 to 20.0% 2021, \$-18 million of cash restructuring costs, exit multiple of 12.9x adj. EBITA 2021 assuming no dividend pay-out 2018-2021